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BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
SOUTHWEST ENVIRONMENTAL UTILITIES,
LLC FOR APPROVAL OF A CERTIFICATE OF
CONVENIENCE AND NECESSITY TO
PROVIDE WATER/WASTEWATER SERVICE.

STAFF'S RESPONSIVE BRIEF

The Utilities Division ("Staff") of the Arizona Corporation Commission ("ACC" or "Commission") hereby files its response to the Closing Brief of Southwest Environmental Utilities, L.L.C. ("SEU" or "Company") filed on June 12, 2015. As was asserted in its Staff Report and at the hearing by Staff witness, Mary Rimback, Staff continues to urge the Commission to deny SEU's request for approval of hook-up fees ("HUFs") for its new certificate of convenience and necessity ("CC&N").

At the conclusion of the hearing herein, the Administrative Law Judge requested that the parties submit briefs addressing cases where the Commission approved HUFs for new CC&Ns as well as how the ACC dealt with HUFs in Docket WS-02987A-08-0180 ("Johnson"), a rate case which involved Johnson Utilities, L.L.C. ("JUL"), SEU's sister company.¹ In an attempt to comply with those requests, Staff undertook to first identify regulated utilities that have been granted HUFs with their initial CC&Ns.

Initially, it is of significance to note that, with the exception of Decision No. 60223 (May 27, 1997) ("Johnson 1") upon which SEU principally relies, Staff found no other dockets where the Commission approved HUFs for a new CC&N. Given SEU's failure to cite to other cases to support such action, and Staff's inability to find any, Staff would submit that there are none. Moreover, Staff believes that the Company's reliance on the provisions of the subsequent Johnson Decision No. 72579 (September 15, 2011) ("Johnson 3") whereby the Commission reinstated the HUFs that were

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¹ George Johnson is the principal for both JUL and SEU.

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1 ordered discontinued in Decision No. 71854 (August 25, 2010) ("Johnson 2") is selective and
2 conveniently ignores other applicable legal considerations.

3 In its Opening Brief, the Company relies on the testimony of its witness, Brad Cole, and the
4 disposition of Johnson 3 in the Johnson rate case as support for adoption of HUFs in this matter. In
5 essence, SEU first asserts that, since the Commission reinstated the HUFs in Johnson 3 that it
6 eliminated in Johnson 2, the ACC should adopt them in this instance. The Company next contends
7 that the percentages of HUFs with which it proposes to fund its water (57.5%) and wastewater
8 (67.18%) plants are the proper proportions vis a vis its proposed equity contributions. Such positions
9 are faulty in several respects, should be distinguished from the instant matter, and should not be the
10 bases upon which the Commission grants the requested HUFs.

11 First, as this tribunal is aware, in 1997 the Commission approved HUFs for JUL when it was
12 granted its CC&N (Johnson 1). Subsequently, the ACC eliminated the HUFs in Johnson 2 after they
13 were fully vetted in the Company's first rate case. The ACC, in essence, *sua sponte*, reinstated JUL's
14 HUFs in Johnson 3. Staff would point out that the Commission did so with the benefit of having
15 examined the performance history of JUL in a full rate case, something the ACC does not yet have
16 the benefit of with SEU. As will be discussed below, in this matter the Commission has no way to
17 determine whether the Company will proceed to invest an appropriate amount of its own funds in the
18 long term or rely mainly on funds from HUFs.

19 Second, it is well settled that each incorporated business, whether an S corporation, C
20 corporation or LLC, is a separate legal entity, independent from any sister company or affiliate.
21 Though Mr. Johnson is a principal of both the Company and JUL, SEU is a separate, start-up utility
22 with no business history. Although Staff is familiar with Mr. Johnson's extensive experience in the
23 water service and wastewater service arenas, as an independent regulated utility, SEU will have to
24 stand on its own merit and establish that it is in the public interest for it to provide water and
25 wastewater services to its customers. *Arizona Water Company v. Arizona Corporation Commission*,
26 177 P.3d 1224, 217 Ariz. 652 (2008).² Staff posits that, though a consideration, the Commission

27 ² Arizona Water involved competing applications for CC&Ns covering the same area. One utility, Woodruff Water, was
28 a new utility that sought an initial CC&N; the other, Arizona Water, wanted an extension of its existing CC&N. There,

1 should not solely or substantially rely on the reputation and/or performance of a sister company (or
2 its principal) as the main basis for decisions germane to SEU's CC&N application.

3 Third, contrary to the assertion of SEU, Staff did not rely solely on its policy of no HUFs for
4 new CC&Ns as the basis for such recommendation. As set forth at page 2 of Ms. Rimback's
5 Memorandum (Attachment C) to the Staff Report, "Staff's chief concern is in regards to the
6 Company assumptions used for the level of investor funds included in projected plant in service and
7 the projected cash flow to operate the Company. Staff's recommendations were developed with a
8 view to increasing the level of investor funds and generating a rate of return which will provide
9 adequate cash flow to operate the Company." Only after an analysis of relevant factors including,
10 without limitation, revenue and expenses, cash flow, rate design and, of great import, SEU's
11 proposed equity contributions, did Staff recommend that no HUFs were appropriate for either the
12 Company's water or wastewater systems.

13 Interestingly, the Company's reliance on Johnson is illustrative of Staff's concern about the
14 amount of HUFs collected by a utility. In fact, the amount of HUFs collected and not used for
15 building off-site plant at the time of the Company's 2008 rate application is noted in Johnson 2.³ At
16 the time it was docketed, over ten years had passed since its initial CC&N was granted and Johnson
17 had amassed off-site HUFs of \$6,931,078 in its water division and \$16,505 in the wastewater
18 division.⁴ The magnitude of such non-investor supplied funds is pertinent to the current case and is
19 of concern to Staff. While SEU correctly posits that the use of HUFs serves to shift risks to
20 developers and lower rates to customers, the Company fails to acknowledge that it gains the wealth of
21 the financial advantage as, in Johnson, the availability of these monies to fund off-site construction
22 frees up the Company's revenues for other myriad uses which it would otherwise have had to expend
23 on plant.

24 ...

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26 the court related that the "seminal inquiry is whether (a new utility) had sufficient resources and expertise to serve the
27 public interest...."

28 ³ Decision No. 71854 at 33:5-7.

⁴ *Id.*

1 As noted above and in its Staff Report, Staff's primary concern pertains to the Company's
2 proposed level of investor funds included in the projected plant in service and projected operating
3 cash flow. Staff's recommendations were developed with a view to increasing the level of investor
4 funds and generating a rate of return which will provide adequate cash flow to operate the Company.
5 SEU asserts that its proposed HUFs place a proportionate and appropriate share of building backbone
6 on the developers.⁵ Staff disagrees and supports the elimination of HUFs to reach its recommended
7 equity percentages. As further evidence of its concern, Staff would also note that the projected
8 balance sheets for the Company provide for zero long-term debt to fund off-site plant.⁶ Such
9 circumstances could lead to a potentially fatal financial result for SEU and its customers, an outcome
10 Staff would like to prevent and of which the Company conveniently ignores in its argument for
11 HUFs.

12 Decision No. 71414 (December 8, 2009) involved H2O, Inc.'s ("H2O") rate case. There, the
13 Commission addressed, *inter alia*, whether unexpended HUFs and developer advances should be
14 treated as contributions in aid of construction ("CIAC") and advances in aid of construction
15 ("AIAC") for purposes of reducing the water company's authorized rate base.⁷ In discussing this
16 "most contentious" issue, the Commission also addressed the underlying issue of the propriety of
17 allowing the continued collection of HUFs.⁸ In that case, Administrative Judge Nodes noted that the
18 "arguments raised by H2O and Staff...point out the inherent tension that exists between the policy of
19 requiring growth to fund growth and assuring that there is sufficient equity investment for sustainable
20 financial viability."⁹ Acknowledging that H2O framed the issue as a matter of "timing," it was noted
21 that "if the Company is allowed to continue to collect hook-up fees and developer advances as the
22 primary means of funding infrastructure, the short-term benefits associated with that strategy could
23 result in devastating long-term consequences when the source of contributed capital no longer exists
24 and customers alone are left to support a utility with minimal equity investment in its infrastructure.

25 ⁵ SEU Opening Brief at 3:1-2.

26 ⁶ Staff Report Schedules MJR-W6 and MJR-WW6.

27 ⁷ Decision No. 71414 at 4:14-17.

28 ⁸ It should be noted that in Decision No.71414, H2O's HUFs were referred to as an "Off-Site Capacity Reservation Charge ("CRC").

⁹ Decision No, 71414 at 9:13-15.

1 Under such scenario, the only likely source of funds would be in the form of substantial, and likely
2 frequent, rate increases because the utility has very little rate base upon which it would be entitled to
3 earn a return.”¹⁰ By adopting the ALJ’s recommendation to cease the HUFs in that case, the ACC
4 recognized his concern that “the Company’s extreme reliance on customer-supplied funds portends
5 future calamity unless an infusion of investor capital occurs to bring [the Company’s] capital
6 structure into balance. The absence of such investment could undermine substantially the Company’s
7 future ability to provide necessary capital to fund needed infrastructure investment.”¹¹ The fact that
8 H2O was a rate case is not lost on Staff. However, Staff would submit that the investor equity
9 concerns and the theories attendant to the over reliance on HUFs discussed therein are of equal
10 import here and should be given due consideration.

11 As SEU notes, both Ms. Rimback and Company witness, Mr. Cole, agree that the Company
12 needs to be invested in its water and wastewater plant. According to Staff, SEU’s pro-forma HUF
13 funding for its water and wastewater plants is 57.57 percent and 67.18 percent, respectively.¹² Based
14 on its analysis, Staff recommends 87.24 percent and 91.50 percent, the difference being Staff’s
15 elimination of the HUFs.¹³ Thus, it is not the fact of being invested, it is the degree thereof. In
16 discussing this factor, the Company criticizes Staff for not providing any analysis for or testimony in
17 support of its percentage breakdown and relying only on the removal of HUFs to get to its figures.
18 Yet, though by such statement the Company would have one believe that it had put forth such
19 analysis in support of its proposed equity percentages, Mr. Cole testified that SEU utilized “rate
20 accountant Tom Bourassa to help formulate the proposed HUFs.”¹⁴ Curiously, Mr. Bourassa did not
21 testify to such formulations nor did SEU submit any further testimony or analysis to explain Mr.
22 Bourassa’s findings other than Mr. Cole’s reference thereto.

23 ...

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26 ¹⁰ *Id.* at 17-24.

27 ¹¹ *Id.* at 25-28.

28 ¹² Staff Report at 3.

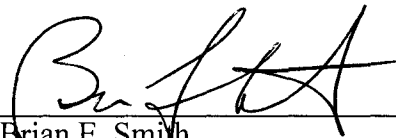
¹³ *Id.*

¹⁴ SEU Opening Brief at 3:12-14.

1 It is interesting to note that in H2O the ACC found that the "failure by H2O's owners to inject
2 sufficient equity, combined with the Company's continued collection of hook-up fees..., has resulted
3 in a situation where in which H2O current has a negative rate base."¹⁵ Though H2O's witness, Mr.
4 Bourassa, "attempted to dismiss H2O's reliance on contributed capital as a 'timing problem,' he
5 conceded that such reliance could be detrimental to the Company and its customers in the long-term
6 because, once growth ceases (and by extension the CIAC and AIAC associated with growth), the
7 Company would be left with an inability to earn a return on rate base and would therefore be unable
8 to make necessary repairs and improvements [citation omitted]."¹⁶ As noted above, the Commission,
9 dismissing Mr. Bourassa's timing argument, discontinued the company's HUFs. The possible
10 negative rate base and inability to generate a return on rate base are of paramount concern to Staff
11 and underscore its recommendation to deny HUFs until SEU has some track record upon which the
12 Commission can make a well-reasoned, fully vetted decision thereon. Staff is using its best efforts to
13 ensure that SEU does not proceed with a financial plan that is a recipe for failure and not in the public
14 interest.

15 For the reasons above-stated, most notably Staff's review and analysis of the Company's
16 proposed financials, Staff's policy of not recommending HUFs for new CC&Ns, the want of any
17 other dockets where HUFs were so authorized save for Johnson 3, the lack of any proposed long-term
18 debt to fund off-site plant, and the proposed percentages of equity infusion for plant by SEU, Staff re-
19 urges the Commission to deny SEU's request for HUFs in this matter.

20 RESPECTFULLY SUBMITTED this 29th day of June 2015.

21 
22 _____
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25 Arizona Corporation Commission
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27 ¹⁵ H2O at 7:16-23.

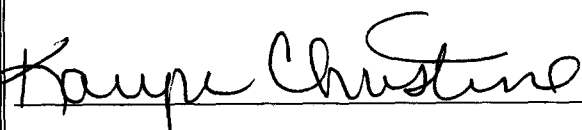
28 ¹⁶ *Id.* 18-23.

1 Original and thirteen (13) copies
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